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The Conforming Loan Limit

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Summary

Congress is concerned with the pace of the recovery in the housing and mortgage markets. A series of laws starting with the Economic Stimulus Act of 2008 (ESA; P.L. 110-185) were designed to increase the availability and affordability of mortgages in "high-cost" areas. This concern about housing and mortgage markets is balanced by attention being paid to possible taxpayer financial risks and the desire to minimize government intervention in economic markets.

Two congressionally chartered government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, provide liquidity to the mortgage market by purchasing residential mortgages from the original lenders and either reselling them as mortgage-backed securities to investors or holding them as investments in their own portfolios. Their charters include a ceiling on the size of loans the GSEs can buy.

Since the end of FY2011 (September 30, 2011), the maximum limit in high-cost areas was reduced to $625,500 from $729,750. The current high-cost limit is calculated as 115% of the area median house price, but cannot exceed 150% of the national limit or $625,500. The limit in other areas of the nation remains unchanged since 2006 at $417,000.

Securitization of mortgages that exceed the applicable limit—called non-conforming jumbo loans—is done by private financial institutions, although in the present financial environment virtually no jumbo mortgages are being securitized. GSE status allows Fannie and Freddie to issue debt at lower cost than other private firms; part of this subsidy is passed on to home buyers in the form of lower interest rates. Interest rates on jumbo mortgages are slightly higher than those on the conforming loans that the GSEs can purchase. The spread between non-conforming jumbo and conforming loan rates has been elevated since the start of the financial crisis and is now about three-fourths of 1%.

According to recent congressional testimony, most recent home purchase mortgages are guaranteed by FHA and securitized by Ginnie Mae; the majority of mortgages purchased recently by Fannie Mae and Freddie Mac have refinanced existing mortgages.

S. 1217, the Housing Finance Reform and Taxpayer Protection Act of 2013, would reduce the maximum high-cost limit from 150% of the national limit ($625,500) to 130% of the national limit ($542,100). H.R. 2767, the Protecting American Taxpayers and Homeowners (PATH) Act of 2013, could reduce the high-cost limit to $525,500.

This report analyzes the implications of the higher conforming loan limit in high-cost areas. It will be updated as legislative and market developments warrant.

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Background

Until they were placed under government conservatorship in September 2008, Fannie Mae and Freddie Mac were stockholder-controlled companies that were chartered by Congress to improve the nation's residential mortgage market and are known as government-sponsored enterprises (GSEs).[1] The charters convey special privileges, but also impose certain restrictions on the GSEs' business activities.

Congress enacted the modern conforming loan limit, which establishes the maximum size mortgage that the GSEs can purchase, in the Housing and Community Development Act of 1980.[2] The initial limit was $93,750 for a single-family home (39% above the Federal Housing Administration (FHA) ceiling at the time), and the law provided for annual increases in the loan limit to adjust for rising prices, as reflected in a housing price index published by the Federal Housing Finance Board (FHFB).[3] This loan limit is the maximum value of a mortgage that Fannie Mae and Freddie Mac can purchase. The loan limit was initially set at a level significantly higher than the national average home price, and with indexation it has remained higher. In 2007, the conforming loan limit stood at 145% of the average new home price, and 162% of the average resale price of an existing home. Since 2006, the basic conforming loan limit has held steady at $417,000.[4] In 2008, the passage of the Economic Stimulus Act of 2008 (ESA; P.L. 110-185) created a temporary higher loan limit in high-cost areas that was 125% of the area median house price, but no greater than 175% of the national median house price. This resulted in limits greater than $417,000 in areas where the median house price exceeded $333,600.[5]

The Housing and Economic Recovery Act of 2008 (HERA; P.L. 110-289) and the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) made temporary and permanent changes to the limits for high-cost areas. With the expiration of the Continuing Appropriations Act of 2011, the conforming loan limit in high-cost areas is determined by the Housing and Economic Recovery Act of 2008 (P.L. 110-289): 115% of area median house price, but not to exceed 150% of the national conforming loan limit, which results in a high-cost limit of $625,500. This results in limits greater than $417,000 in areas where the median house price exceeds $362,609. According to a study by Federal Reserve economists,[6] if the HERA limits had applied in 2010, 1.3% of home-purchase mortgages and 1.3% of refinance mortgages that were eligible for GSE purchase would not have been eligible for purchase by Fannie Mae and Freddie Mac. On the other hand, of those mortgages that would have lost their eligibility, 53.4% of those used to purchase a home and 59.6% of those used to refinance were purchased by the GSEs.

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[1] For more information about Fannie Mae and Freddie Mac, see CRS Report RL34661, *Fannie Mae's and Freddie Mac's Financial Problems*, by N. Eric Weiss.

[2] P.L. 96-399, 94 Stat. 1616 et seq.

[3] Higher limits were set for home mortgages covering two-, three-, and four-unit dwellings. See 12 U.S.C. 1454 for Freddie Mac and 12 U.S.C. 1717 for Fannie Mae.

[4] The Housing and Community Development Act set a higher limit for mortgages on residences in Alaska, Hawaii, and Guam, all thought at the time to have higher than normal costs of building and lower than normal access to credit because of their remoteness. In those areas, the conforming loan limit was set at 150% of the limit that applied to the rest of the nation. In 1992, the Virgin Islands were added to the list of areas where the 150% limit applied (by §1382(k) of P.L. 102-550).

[5] Mathematically, $333,600 times 125% equals the nationwide limit of $417,000.

[6] Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, and Glenn B. Canner, "The Mortgage Market in 2010: Highlights from the Data Reported under the Home Mortgage Disclosure Act," *Federal Reserve Bulletin*, vol. 97, p. 32. The research also examined the impact on FHA-insured mortgages.

The Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) set the high-cost limit for mortgages insured by the Federal Housing Administration (FHA) at 125% of area median house price, not to exceed 175% of the national limit or $729,750. Prior to this law, the high-cost FHA mortgage limit was identical to the GSE high-cost conforming loan limit.[7] In other areas, the FHA mortgage limit was and is 65% of the national conforming loan limit or $271,050. The interaction between the 125% of area median house price and the $271,050 national limit raises the high-cost limit in areas where the median house price is greater than $216,840.

According to recent congressional testimony, most recent home purchase mortgages are guaranteed by FHA and securitized by Ginnie Mae; the majority of mortgages purchased recently by Fannie Mae and Freddie Mac have refinanced existing mortgages.[8]

Legislation to Raise the Loan Limits

Since 2008, Congress has adjusted the conforming loan limit five times. The first bill was ESA, which enacted a temporary increase in the conforming loan limit.[9] For mortgages originated between July 1, 2007, and December 31, 2008, the loan limit for an area was the greater of (1) the existing limit of $417,000 or (2) 125% of the area median home price, *not to exceed* a ceiling of 175% of the statutory limit, or $729,750.[10] A total of 71 metropolitan and micropolitan statistical areas had higher 2008 conforming loan limits, including 224 counties and cities not in counties. There were 21 counties outside of metropolitan or micropolitan areas with increases in 2008.

HERA permanently removed the single conforming loan limit for the contiguous 48 states.[11] The loan limit is higher in metropolitan statistical areas—defined as "high-cost"—where the median home sale price exceeds the current conforming loan limit. Under HERA, the conforming loan limit for those areas was 115% of the median home price in the area, except that increases were to be capped at 150% of the statutory loan limit (the limit that now applies to Alaska, Hawaii, and the two island territories). This system for determining the limit took effect when the temporary limits set by the stimulus act expired on December 31, 2008. Subject to the requirement in their charters that loans purchased be no more than one year old, the GSEs were able to purchase high-cost conforming loans after December 31, 2008.

ARRA returned the conforming loan limits for mortgages originated in 2009 in high-cost areas to the 2008 ESA limit, that is, the high-cost limit was set at 175% of the statutory limit or $729,750.[12] The Federal Housing Finance Agency (FHFA), which is both regulator and conservator of the GSEs, was authorized to create subarea limits, but has declined to do so. The FY2010 Department of the Interior Appropriations Act (P.L. 111-88) applies the ESA limits to mortgages originated in calendar 2010.

[7] For more information about FHA-insured mortgages, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview*, by Katie Jones. FHA publishes the loan limits at https://entp.hud.gov/idapp/html/hicostlook.cfm.

[8] Testimony of Laurie S. Goodman, Amherst Securities Group to the Subcommittee on Housing Transportation, and Community Development of the Senate Committee on Banking, Housing, and Urban Affairs, September 20, 2011, available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=dc3d9918-5aca-47b2-9ce4-b9daaef67957.

[9] P.L. 110-185, 122 Stat. 613 et seq.

[10] The list of affected areas is available at http://www.ofheo.gov/media/hpi/AREA_LIST.pdf.

[11] P.L. 110-289, 122 Stat. 2654 et seq.

[12] P.L. 111-5, 123 Stat. 115 et seq.

The Continuing Appropriations Act of 2011 (P.L. 111-242) continued the ESA limits to mortgages originated in FY2011. They were not continued, however, into FY2012. Therefore the current limits are those set by HERA.

Table 1. Summary of High-Cost Area Limits

Mortgages Purchased Dates	Applies to Mortgages Originated Between	Percentage of Area Median	Percentage of National Limit	Applicable Law
Feb. 13, 2008 - Dec. 31, 2008	July 1, 2007 - Dec. 31, 2008	125%	175%	Economic Stabilization Act of 2008 P.L. 110-185
Jan. 1, 2009 - Feb. 16, 2009	On or After Jan. 1, 2009	115%	150%	Housing and Economic Recovery Act of 2008 P.L. 110-289
Feb. 17, 2009 - Sept. 30, 2009	On or After Feb. 17, 2009	125%	175%	American Recovery and Reinvestment Act of 2009 P.L. 111-5
Oct. 30, 2009 - Sept. 30, 2010	On or After Oct. 30, 2009	125%	175%	Department of the Interior Appropriations for FY2010 P.L. 111-88
Oct. 1, 2010 - Sept. 30, 2011	Oct. 1, 2010 - Sept. 30, 2011	125%	175%	Continuing Resolution for FY2011 P.L. 111-242
On or After Oct. 1, 2011	On or After Jan. 1, 2009	115%	150%	Housing and Economic Recovery Act of 2008 P.L. 110-289

Source: LIS.

Notes: Ending date in "Mortgage Purchased Dates" is effective date of superseding amendment.

A look at median prices in various metropolitan areas of the country shows that the conforming limit is rising in several localities under ESA, and (in fewer areas) has risen under HERA. **Table 2** shows the current conforming loan limit for selected areas. Some areas (including Barnstable, MA; Boulder, CO; Miami, FL; and Riverside, CA) are now subject to the nationwide conforming loan limit, but under earlier law were high-cost areas.

Table 2. Current High-Cost Conforming Loan Limits in Selected Areas

High-Cost Housing Area	Loan Limit
High Cost Area Limit is Lesser of:	
—Percentage of Area Median	115%
—Percentage of 2008 Limit ($417,000)	150%
Boston/Quincy/Cambridge, MA	$465,750
Bridgeport/Stamford/Norwalk, CT	$601,450
Los Angeles/Long Beach/Santa Ana, CA	$625,500
New York City/N. NJ/Long Island, NY/NJ	$625,500
Newark/Union, NJ	$625,500
Sacramento/Arden/Arcade/Rosedale, CA	$474,950

High-Cost Housing Area	Loan Limit
San Diego/Carlsbad/San Marcos, CA	$546,250
San Francisco/Oakland, CA	$625,500
San Jose/Sunnyvale/Santa Clara, CA	$625,500
Seattle/Tacoma/Bellevue, WA	$506,000
Washington, DC/MD/VA	$625,500

Source: Federal Housing Finance Agency, *Maximum Loan Limits that Apply to Loans Acquired in Calendar Year 2013 and Originated after 9/30/2011 or Prior to 7/1/2007*, available at http://www.fhfa.gov/webfiles/24674/FullCountyLoanLimitList2013_HERA-BASED_FINAL.xlsx.

The Impact of Raising the Conforming Loan Limit

The existence of high-cost housing areas implies that the benefits of the GSE subsidy are not distributed uniformly. GSE status allows Fannie and Freddie to borrow at lower interest rates than non-GSE financial institutions.[13] A portion of this subsidy is passed on to home buyers whose mortgage loans are purchased and securitized by the GSEs. In 2003, Fannie and Freddie purchased 35.1% of all mortgages (by dollar value) originated nationwide. This percentage varied from state to state. In three states (California, New York, and Connecticut) and the District of Columbia, the GSEs purchased less than 30% of new mortgages. In 15 states, on the other hand, the two GSEs purchased more than 40% of new mortgages.[14]

In high-cost areas, the GSEs' mortgage purchase and securitization operations are constrained by the conforming loan limit. Loans that exceed the conforming loan limits can only be securitized by non-GSE issuers, and prior to the recent recession, there was a large secondary market for jumbo mortgage loans. In 2006, total prime jumbo loan originations were estimated at $480 billion, while $219 billion in prime jumbo mortgage-backed securities (MBS) were issued, implying a securitization rate for jumbo mortgages of 45.6%.[15] By contrast, Fannie and Freddie securitized 83% of loans originated in 2006 in the conventional, conforming mortgage markets where they are allowed to operate.[16]

Conforming mortgage loans tend to carry lower interest rates than nonconforming loans. A number of studies have attempted to measure the spread between conforming mortgage and jumbo loan rates and the extent to which the rate differential can be attributed to the subsidy contained in GSE status.[17] Most estimates of the spread between conforming and jumbo loans

[13] Before conservatorship, the chief financial advantage conveyed to Fannie and Freddie by GSE status was the "implicit guarantee." Although GSE debt is not explicitly backed by the full faith and credit of the Treasury, market participants have long believed that the government will not allow either GSE to become insolvent. Under conservatorship the GSEs have direct financial support from the federal government and the guarantee on their debt is all but explicit.

[14] *The 2006 Mortgage Market Statistical Annual*, vol. 1, p. 25.

[15] *The 2008 Mortgage Market Statistical Annual*, vol. 2, p. 3.

[16] Ibid.

[17] See U.S. Congressional Budget Office, *Updated Estimates of the Subsidies to the Housing GSEs*, April 8, 2004; Wayne Passmore, Shane Sherlund, and Gillian Burgess, "The Effect of Government Sponsored Enterprises on Mortgage Rates," *Real Estate Economics*, vol. 33, fall 2005; Joseph A. McKenzie, "A Reconsideration of the Jumbo/Non-Jumbo Mortgage Rate Differential," *Journal of Real Estate Finance and Economics*, vol. 25, September-December 2002, p. 197; and Brent Ambrose, Michael LaCour-Little, and Anthony Sanders, "The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis," *Real Estate Economics*, vol. 32, winter 2004, p. 541.

have fallen into the range of 18-60 basis points. (A basis point is one one-hundredth of a percent.) All researchers assume that at least part of this spread is due to the GSE subsidy, but other factors are involved. For example, as properties become more expensive, lenders worry more about price volatility. That is, as the risk of a significant drop in the market value of the house—the loan's collateral—increases, lenders raise rates to compensate for that risk. Second, the existing jumbo secondary market cannot realize certain economies of scale because market participants are largely frozen out of the conforming loan market (due to their inability to compete with the GSEs). These and other factors suggest that allowing the GSEs into the jumbo market would not cause the entire spread to disappear. There is no consensus as to how much of the 18-60 basis point spread is due to the GSE subsidy—estimates range as low as 4 basis points.[18]

Thus, it is uncertain how significant the benefits would be if the conforming loan limit were increased during normal times. As a rough guide to the size of potential savings, assume that the interest rate on a 30-year, 4.00% mortgage is reduced to 3.75%. Over the 10-year average life of a mortgage, the savings would be about $10,750, or approximately $90 per month. Of course, this figure shrinks if some portion of the rate spread persists, if, that is, not all the savings are passed through to borrowers. If the interest rate paid by the hypothetical home buyer in the example above falls by only seven basis points, the monthly payments are lower by about $28 a month, and interest savings would be about $4,400 over 10 years.[19]

The Conforming Loan Limit During the Crisis

With the housing market downturn that began in 2006, there is a new rationale for a higher conforming loan limit: to stimulate the jumbo mortgage market, which would in turn provide stimulus for the housing sector and the economy. Credit conditions in the jumbo market are said to be unusually tight—the spread between jumbo and conforming loan rates has widened. In August 2013, the interest rate on a "conforming jumbo" was approximately the same as the interest rate on a conforming mortgage and the spread on a "non-conforming jumbo" was around 34 basis points.[20] Since 2007, the market for private, non-GSE mortgage-backed securities has all but disappeared, as investors are unwilling to accept the risks without the GSE guarantee.

Another reason why non-conforming loans are more expensive is that in the absence of a secondary market for jumbo loans, lenders must hold the loans on their own books and bear the risk of further drops in home prices and increases in defaults due to the weak economy.

Allowing the GSEs to securitize some jumbo loans restored liquidity to the part of the secondary market covered by the higher limits, enabled lenders to transfer the risk of holding jumbo mortgages, and made loans more affordable and available. The conservatorship of Fannie and

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[18] See Passmore, Sherlund, and Burgess, op. cit., and Lehnert, Passmore, and Sherlund, *GSEs, Mortgage Rates, and Secondary Market Activities*, Finance and Economics Discussion Series, Federal Reserve, 2006-30. The latter paper found no significant effect on mortgage rate spreads.

[19] Note also that under HERA, ESA, and ARRA not all mortgages in high-cost areas are conforming loans. Loans for amounts greater than 150% or 175% of the statutory limit are nonconforming. In other words, the top end of the housing market is unaffected by the bills' provisions. Also, during the mortgage market turmoil of 2008, the difference in interest rates for conforming loans and jumbo loans that were not GSE-purchasable frequently was more than one percentage point. There was some evidence that there was no difference in rates on jumbos that the GSEs could purchase (e.g., $500,000 in the Washington, DC, area) and jumbos that the GSEs could not purchase (e.g., $800,000).

[20] Bloomberg, "Key Rates, Mortgage Rates and CD Rates," October 5, 2011, available at http://www.bloomberg.com/markets/rates-bonds/key-rates/.

Freddie and the Treasury financial support are indicative of strong government support for the GSEs that should reduce the risk to lenders of jumbo loans that are purchased by the GSEs.

According to the Securities Industry and Financial Markets Association (SIFMA), there has been a very slight resurgence in non-GSE MBS issuance—the value of such bonds issued in the first six months of 2013 was $39.8 billion, compared with $946.4 billion issued by the government agencies: Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and Ginnie Mae.[21] In the first six months of 2012, $16.7 billion of MBS was issued by the private sector as compared with $789.9 billion by government agencies.

Policy Issues

The case for a higher conforming loan limit is based partly on equity concerns. Home buyers in the conforming mortgage market may receive part of the GSE subsidy in the form of lower interest rates. Because housing prices vary across the nation, the geographical distribution of this benefit is uneven. Before the increases in high-cost areas, the loan limit was $417,000; in many parts of the country, this amount covers all but the top end of the housing market. In high-cost areas such as San Francisco or New York City, on the other hand, a large proportion of real estate transactions exceed that limit.

A counter-argument is that the additional subsidy created by raising the loan limit would go overwhelmingly to mortgage holders with high incomes. If the purpose of the GSEs is to foster home ownership, the impact of raising the limit is likely to be minor: those who would benefit from the change already have high homeownership rates.

Another key issue is risk. As noted above, the non-conforming jumbo home market is dormant because perceptions of risk are sharply higher than they were during the boom. Lenders are more cautious because the value of their collateral—the house—may drop further. MBS investors have the same fear, making it harder for lenders to transfer price and credit risk to the secondary market. GSE entry into the jumbo market would appear to meet the needs of both lenders and investors: the GSE (and the implicit Treasury) guarantee would reassure MBS buyers, leading to a resumption of securitization, in turn encouraging lenders to make loans at more affordable rates.

But GSE participation would not reduce overall risk in the market, it would simply shift that risk to the taxpayers. As house prices continue to fall, and delinquencies and foreclosures continue to rise, the GSEs have lost billions of dollars and now depend on special support from the federal government. The ultimate cost to taxpayers of this intervention is unknown.

If the current tightness in the mortgage market reflects an overreaction on the part of market participants in the grip of panic, some argue that a higher conforming loan limit may be a useful corrective and avert unnecessary damage to housing markets and the economy. On the other hand, if market fundamentals dictate that home prices decline further, the assumption of more risk by the GSEs (and, more or less implicitly, by the Treasury) could arguably slow the market adjustment process and foster an unwelcome expectation in financial markets that investors will be rescued from the consequences of their own mistakes.

[21] Securities Industry and Financial Markets Association (SIFMA), "U.S. Mortgage-Related Issuance and Outstanding," available at http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Mortgage-Related-SIFMA.xls?n=05272.

Appendix. Previous Conforming Loan Limits

Table A-1. Conforming Loan Limits in Selected Areas

High-Cost Housing Area	**Loan Limit**				
Applies to Mortgages Originated Between	July 1, 2007 to Dec. 31, 2008	Jan. 1, 2009 to Feb. 16, 2009	Jan. 1, 2009 to Dec. 31, 2009 (See note)	Jan. 1, 2010 to Sept. 30, 2011	Oct. 1, 2011 to present
Mortgages Purchased Between	Feb. 13, 2008 to Dec. 31, 2009	Jan. 1, 2009 to Feb. 16, 2009	Feb. 17, 2009 to Dec. 31, 2009	Jan. 1, 2010 to Sept. 30, 2011	Oct. 1, 2011 to present
High Cost Area Limit is Lesser of:					
—Percentage of Area Median	125%	115%	125%	125%	115%
—Percentage of 2008 Limit	175%	150%	175%	175%	150%
Barnstable Town, MA	$462,500	$417,000	$462,500	$462,500	$417,000
Boston/Quincy/Cambridge, MA	$523,750	$465,750	$523,750	$523,750	$465,750
Boulder, CO	$460,000	$417,000	$460,000	$460,000	$417,000
Bridgeport/Stamford/Norwalk, CT	$708,750	$511,750	$708,750	$708,750	$575,000
Los Angeles/Long Beach/Santa Ana, CA	$729,750	$625,500	$729,750	$729,750	$625,500
Miami/Ft. Lauderdale, FL	$423,750	$417,000	$423,750	$423,750	$417,000
New York City/N. NJ/Long Island, NY/NJ	$729,750	$625,500	$729,750	$729,750	$625,500
Newark/Union, NJ	$729,750	$625,500	$729,750	$729,750	$625,500
Riverside/San Bernardino, CA	$500,000	$417,000	$500,000	$500,000	$417,000
Sacramento/Arden/Arcade/Rosedale, CA	$580,000	$474,950	$580,000	$580,000	$580,000
San Diego/Carlsbad/San Marcos, CA	$697,500	$546,250	$697,500	$697,500	$546,250
San Francisco/Oakland, CA	$729,750	$625,500	$729,750	$729,750	$625,500
San Jose/Sunnyvale/Santa Clara, CA	$729,750	$625,500	$729,750	$729,750	$625,500
Seattle/Tacoma/Bellevue, WA	$567,500	$506,000	$567,500	$567,500	$506,000
Washington, DC/MD/VA	$729,750	$625,500	$729,750	$729,750	$625,500

Source: Loan limits (P.L. 110-185) are from Federal Housing Finance Agency, *Conforming Loan Limit,* available at http://www.fhfa.gov/Default.aspx?Page=185.

Notes: ARRA raised the high-cost conforming loan limit on mortgages originated in calendar 2009. The Continuing Appropriations Act of 2011 (P.L. 111-242) extended the limits that were previously extended in the FY2010 Interior Appropriations (P.L. 111-88).

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